This record is a partial extract of the original cable. The full text of the original cable is not available.

UNCLAS SECTION 01 OF 02 MANILA 005519

SIPDIS

Sensitive

STATE FOR EAP/EP, EB/IFD, E
STATE ALSO PASS FED RESERVE SAN FRANCISCO
STATE ALSO PASS EXIM, OPIC, AND USTR
STATE ALSO PASS USAID FOR AA/ANE and AA/G
TREASURY FOR OASIA

E.O. 12958: N/A
TAGS: EFIN EINV RP
SUBJECT: Turning Bad Loans into Good Assets

Sensitive but Unclassified - Protect Accordingly.

Summary

¶1. (SBU) The Philippine Central Bank (BSP) has cleaned up 19% of the non-performing assets (NPAs) in the banking system through the Special Purposes Vehicle (SPV) law. Although the BSP target was 50%, it reduced the amount of NPAs to 9% of total bank assets. By forming an SPV, companies can buy NPAs, which consist of non-performing loans and acquired assets, and try to profit from them. Although the banks recover only 23 cents on the dollar, it frees up capital for new lending. The RP Congress is likely to extend the SPV law for another two years by early 2006. End Summary.

Selling Off Bad Debts

¶2. (SBU) According to Bangko Sentral ng Pilipinas (BSP) Deputy Governor Nestor Espenilla, the BSP has achieved modest success in getting rid of bad debts in the banking sector. Through the Special Purpose Vehicle (SPV) law, the banking system sold 97 billion pesos (about $1.8 billion) worth of the non-performing assets (NPAs). This reflected about 19% of the total amount of NPAs in the banking system. Although the figure fell short of the BSP target of 50%, it reduced the amount of NPAs from 18% to 9% of total banking assets. Although SPV law expired in April 2005, the BSP is hoping to extend Congress will extend the law for another two years. Espenilla said the draft bill is the exact same law but gives banks more time to sell off non-performing assets. The SPV bill is currently in its second reading in both houses.

¶3. (U) Espenilla said non-performing assets (NPAs) in the Philippines consist of two-thirds non-performing loans (NPLs) and one-third aquired assets (also known as ROPOA - real and other properties owned or acquired). Eighty percent of the NPAs addressed to date through the law were acquired assets, mainly real estate from foreclosures, because domestic banks and AMCs are more eager to set up SPVs and prefer concrete assets they can manage and sell. Real estate prices near metro Manila, for example, have risen dramatically in recent years. There are fewer foreign investors interested in setting up special purpose vehicles, and they are more likely to buy loans (NPLs) because local property laws prevent foreign ownership of real estate.

¶4. (U) By forming an SPV, a bank or Asset Management Companies (AMC) becomes a legal entity with the rights to acquire non-performing assets. The SPV may then try to strike a deal with the borrower, sell the asset to a collection agency or vulture fund, or try to make a return on the acquired assets through use, rental, or resale. The SPV law facilitates the formation of private and decentralized AMCs. The government provides no financing but offers incentives, such as reduced transfer taxes and capital gains taxes for SPVs. The government also eliminates the documentary stamp tax and gross receipts tax because these cause friction over the transaction. Espenilla said the banks are writing off about 77% of the debt amount, so are getting only 23 cents on the dollar. Banks have to disclose 100% of the loss on the sale, but are allowed to spread the write-off of that loss over ten years.

¶5. (U) In addition to tax incentives, the BSP is adopting Basel II provisions to punish banks for retaining bad loans. For example, the GRP increased the risk weighting that banks must carry on its NPAs from 100% to 125% in 2006 and will be increasing it to 150% by
¶2007.

Comment

¶6. (SBU) Even with the success of the SPV, 20-25% of many bank loans are classified officially as NPLs or acquired assets. Changes are still needed in the Philippine banking system to ensure better transparency, oversight, and profitability. The Philippine Stock Exchange, for example, requires no reporting on asset quality on a quarterly or biannual basis, although some banks provide a few summary ratios in their interim accounts. Many banks reported a return on assets of less than 1% and a return on equity of well under 10% in the first half of 2005, reflecting a continued large base of NPLs. Further cleaning up the bad debts and NPLs through an extended SPV law would create headroom for banks to fund better-performing loans and profitable investments.

Jones